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Published 24 October 2013

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AUDIT COMMITTEE

REVISED INFORMATION FOR AGENDA ITEM 6 – TREASURY MANAGEMENT MID-YEAR REVIEW.

Thursday 12 December 2013
2.00 pm
Warspite Room, Council House

Members:
Councillor Wheeler, Chair
Councillor Dr. Mahony, Vice Chair
Councillors Murphy, Stark and Stevens.

Independent Members:
Ros Badger, Mr Clarke and Mr Stewart.

Please find enclosed a revised report for agenda item 6 – this replaces the report attached to the original agenda.

Tracey Lee
Chief Executive

AUDIT COMMITTEE

6. TREASURY MANAGEMENT MID YEAR REVIEW 2013/14 **(Pages 1 - 24)**

The Committee will be provided with the Treasury Management and Mid-Year Review 2013/14.

PLYMOUTH CITY COUNCIL

Subject:	Treasury Management Strategy 2013/14 – Mid Year Review
Committee:	Audit Committee
Date:	12 December 2013
Cabinet Member:	Councillor Mark Lowry
CMT Member:	Malcolm Coe (Assistant Director for Finance, Efficiencies, Technology & Assets)
Author:	Andrew Liddicott
Contact details	Tel: 01752 304596 email: andrew.liddicott@plymouth.gov.uk
Ref:	ACCT/AL
Key Decision:	No
Part:	I

Purpose of the report:

The Local Government Act 2003 requires the Council to set out its Treasury Strategy for borrowing and to prepare an Annual Investment Strategy. The Council's strategy for 2013/14 was approved by full Council at its budget meeting on 25 February 2013. This report provides an update on the progress and outcomes against the Treasury Management Strategy for the six month period ended 30 September 2013. It is a requirement of the CIPFA Code of Practice on Treasury Management that a full mid-year report, as a minimum, should be presented to Full Council.

The Brilliant Co-operative Council Corporate Plan 2013/14 - 2016/17:

Effective financial management is fundamental to the delivery of corporate improvement priorities. Treasury Management activity has a significant impact on the Council's activity both in revenue budget terms and capital investment and is a key factor in facilitating the delivery against a number of corporate priorities.

Implications for Medium Term Financial Plan and Resource Implications: Including finance, human, IT and land

Treasury Management affects the Council's budget in terms of borrowing costs and investment returns.

Other Implications: e.g. Child Poverty, Community Safety, Health and Safety and Risk Management:

N/A

Equality and Diversity

Has an Equality Impact Assessment been undertaken? No

Recommendations and Reasons for recommended action:

1. The report be noted and presented to Full Council.

Alternative options considered and rejected:

It is statutory requirement under the Local Government Act 2003 and supporting regulations to set an annual treasury strategy for borrowing and prepare an annual investment strategy. The Council has adopted the Cipfa Code of Practice for Treasury Management which requires a mid-year report to be submitted to the Audit Committee and Full Council covering the performance against this approved strategy.

Published work / information:

Treasury Management Strategy report to Council 25 February 2013
Treasury Management Practices update for 2013-14 report to Audit Committee 14 March 2013

Background papers:

Title	Part I	Part II	Exemption Paragraph Number						
			1	2	3	4	5	6	7
Not applicable									

Sign off:

Fin	CorpFS 151-1314002	Leg	19026/DVS	Mon Off	TH 0139	HR		Assets		IT		Strat Proc	
Originating SMT Member - Malcolm Coe													
Has the Cabinet Member(s) agreed the contents of the report? Yes													

Treasury Management Strategy Mid-Year Review

1. Introduction

1.1 The Treasury Management Strategy for 2013/14 was approved by full Council at its meeting of the 25th February 2013. The Treasury Management Strategy has been underpinned by the adoption of the Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management 2011, which includes the requirement for determining a treasury strategy on the likely financing and investment activity for the forthcoming financial year. The Code also recommends that members are informed of treasury management activities at least twice a year. This report therefore ensures this authority is embracing best practice in accordance with CIPFA's recommendations.

1.2 Treasury Management is defined as:

"The management of the local authority's investments and cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks. "

1.3 The responsibility for implementing and monitoring treasury management policies and practices and for the execution and administration of treasury management decisions is delegated by the Council to its Section 151 Officer and is overseen by a Treasury Management Board consisting of Councillors and senior officers of the Council.

1.4 The day to day operation of the treasury management activity is carried out in accordance with detailed Treasury Management Practices (TMP's). Updates to these practices for 2013-14 were approved by the Audit Committee on 14th March 2013.

1.5 The Council works closely with its treasury management advisers, Arlingclose, who assist the Council in formulating views on interest rates, regular updates on economic conditions and interest rate expectations, and advise on specific borrowing and investment decisions.

1.6 This report therefore provides an update on the Council's treasury management activity for the period ended 30th September 2013 together with performance against approved Treasury Management Prudential Indicators. In accordance with Treasury Management Practice (TMP) note 6, the report is required to be presented to Full Council.

2. Economic Background

2.1 Before reviewing the Council's performance to date it is appropriate to outline the national and economic background within which council officers have operated during the first part of the year. The key financial issues are outlined below.

Growth: The UK economy showed some improvement, with consumer spending boosting growth. GDP for the first quarter of 2013 was revised up to +0.4% and for the second quarter was +0.7%. Recent data suggests a stronger rate in quarter three. Revisions by the Office of National Statistics to GDP back-data showed the UK avoided a double-dip recession in 2012, but that the downturn in 2008-09 was deeper than previously estimated. Growth is now still over 3% below its peak back in 2007.

Some positive signs for household spending emerged. The deterioration in real earnings growth (i.e. earnings less inflation) slowed, which implied a slower erosion of purchasing power. Consumer confidence improved. Household savings rates remained high, which is unsurprising given the uncertain economic outlook, but appear to be on a downward track, suggesting spending was being driven by borrowing or lower savings. This raises questions about the sustainability of the recovery at these rates of growth.

Inflation: Annual CPI for August (published September) was 2.7%. Inflation fell in line with expectations and is expected to remain close to this level throughout the autumn. Further out, inflation should fall back towards the 2% target as external price pressures fade and a revival in productivity growth curbs domestic cost pressures. The oil price (Brent Crude) climbed above $100/barrel on the back of political unrest in Egypt and the unresolved crisis in Syria.

Monetary Policy: There was no change to UK monetary policy with official interest rates and asset purchases maintained at 0.5% and £375bn respectively. The main development for UK monetary policy was the start of Mark Carney's tenure as Governor and the implementation of forward guidance. Within the August Inflation Report, the Bank stated its forward guidance, the main element of which is to defer monetary tightening at least until the ILO Unemployment Rate falls to a threshold of 7% (among a raft of caveats). The Bank projected that the probability of this happening would remain below 50% until 2016. The Governor has had to defend the Bank's guidance in the face of rising financial market expectations of an earlier rate rise on the back of the encouraging economic data.

In his testimony to Congress on 22nd May the US Federal Reserve Chairman Ben Bernanke stated that, if the emerging recovery in the US economy became established, the Fed would reduce its $85bn monthly asset purchase programme (QE). The apparent movement by the Fed towards tapering its open-ended QE programme prompted extreme asset price volatility in bonds and equities, as investors sought to crystallise gains driven by excessive liquidity. As a consequence, government bond yields spiked. There had been a growing expectation that the Federal Reserve would seek to commence 'tapering' in September but they took markets by surprise and maintained asset purchases at the existing level.

Global: Whilst the outlook for the global economy appeared to have improved over the first half of calendar 2013/14, significant economic risks remain, particularly in China and the Eurozone. The Chinese banking system is facing tighter liquidity conditions as officials seek to slow down rampant credit growth, and, despite the time gained by the ECB to allow individual members and the Eurozone as a whole to reform their economies, the Eurozone debt crisis has not gone away. The region appears to be dragging itself out of recession and September's German general election passed with little incident but political uncertainties, particularly in Italy, could derail any progress towards a more balanced and stable regional economy. The US recovery appeared to be in train, but a lack of agreement on the federal budget by the end of September caused a partial government shutdown at the start of October, which could have an effect on GDP growth. Political risks also remain regarding the debt ceiling.

Money market data and PWLB rate movements over the first half of 2013/14 are attached as Appendix 1 to this report.

3 The Council's Strategy for 2013/14

3.1 The Council's Treasury Management Strategy was approved by Full Council on 25th February 2013. As an overriding principle, the strategy proposed that the Council would continue to minimise risk contained within its current debt and investment portfolios by establishing an integrated debt management and investment policy which balanced certainty and security, with liquidity and yield. The Council would continue to make use of short term variable rate borrowing, whilst at the same time seeking to balance its investments across a range of investment instruments, diversifying from pure cash investments into a wider range of asset classes.

3.2 The borrowing strategy was to be based on affordability and subject to credit conditions throughout the year. With the improvement in credit conditions the strategy was to borrow short-term funding from other local authorities up to the Council's Capital Financing Requirement (CFR) allowing internal balances to be externally invested. In adverse credit conditions the strategy was to use internal balances, to cover any borrowing requirement, reducing counterparty and credit risk.

4. Review of the Council's Performance April – September 2013

4.1 Table 1 shows the Council's overall treasury portfolio at 30th September 2013 compared to the position at the start of the year.

Table 1

01/04/2013 £m	Average Interest rate %		30/9/2013 £m	Average Interest rate %
		External Borrowing Long-term:		
61.315	5.4001	PWLB	61.315	5.4001
130.000	4.4202	Market	130.000	4.4202
0.087	1.0007	Bonds	0.802	0.7711
34.800	0.2809	Temporary Borrowing	51.690	0.2725
226.202	**4.4077**	**Total PCC Borrowing**	**243.807**	**3.7753**
		Long-term liabilities		
30.247	8.7300	PFI Schemes	30.247	8.7300
2.189	n/a	Finance Leases	2.189	n/a
9.156	n/a	Cornwall County Council (TBTF)	9.156	n/a
267.794		**Total External Debt**	**285.399**	
(77.374)	0.8889	Bank Deposits	(117.241)	0.7757
(5.000)	Variable	Property Fund (Pooled investment)	(5.000)	Variable
		Managed funds (Pooled Investments)	(5.025)	Variable
(82.374)		**Total Investments**	**(127.266)**	
185.420		**Net Borrowing/(Net Investment) Position**	**158.133**	

Borrowing

4.2 Under Section 3 of the Local Government Act 2003 and supporting regulations the Council must determine and keep under review how much it can afford to borrow. The Council is required to set two limits:

- The Authorised Limit
- The Operational Boundary

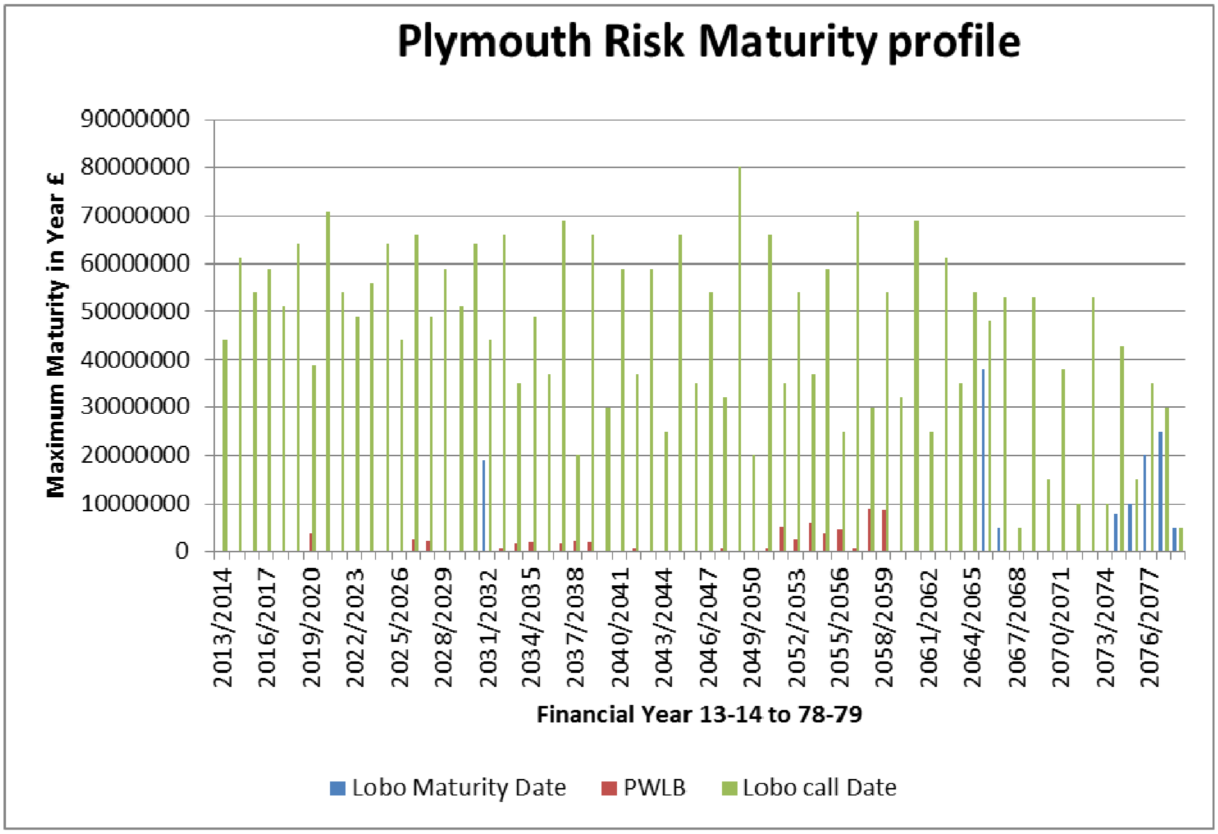
4.3 The external debt limits for 2013/14, as approved by Council in February 2013, are as follows:

- Authorised limits £310m
- Operational Boundary £289m

4.4 The maximum external debt outstanding during the period was £286.9m on 24th September 2013 (including £41.6m for the PFI scheme, finance leases and Tamar Bridge debt administered by Cornwall County Council). This was within both the authorised limit and the operational boundary. At 30th September 2013 total external debt reduced to £285.4m with external borrowing excluding PFI, Finance leases and Tamar Bridge debt at £243.8m, including £52.492m of short-term loans.

4.5 The following graph shows the maturity profile of the Council's long-term borrowing at 30th September 2013:

Figure 1



4.6 The debt portfolio currently includes £130m of LOBO loans. These loans have various option call dates where the banks have the ability to amend the loan terms and at which point the Council could choose to repay the loan if the terms are changed. This is reflected within the maturity profile shown above (in green) to enable officers to risk manage the Council's cashflows. To 30th September 2013 £24m of loans had reached their call option dates. No options were exercised and these loans will continue at fixed rates until the next option dates in 2 years time.

4.7 Table 2 shows the movement in the borrowing portfolio during the year.

Table 2

	Balance on 01/04/2013 £000s	Debt Maturing £000s	Debt Repaid £000s	New Borrowing £000s	Balance on 30/09/2013 £000s	Increase/ (Decrease) in Borrowing
Short Term Borrowing	34,887	(56,400)	0	74,005	52,492	17,605
Long Term Borrowing	191,315	0	0	0	191,315	0
TOTAL BORROWING	**226,202**	**(56,400)**	**0**	**74,005**	**243,807**	**17,605**

4.8 New borrowing in year

The use of short-term borrowing has continued to be the most cost effective means of financing capital expenditure and cashflow requirements. During the first half of the year the level of borrowing was constrained within a maximum investment level to generate additional revenue savings whilst maintaining the risk of excessive level of investments. By matching any short-term borrowing with the available liquid deposits held in bank call accounts, this has lowered overall treasury risk by allowing flexibility of reducing debt and investment levels at short notice should credit conditions deteriorated.

The Council started the year with £34.887m of short–term loans with £74.005m of new loans taken and £56.4m of loans maturing in 2013/14. The average period of new loans taken in the period 1st April 2013 to 30th September 2013 was 101.32 days at an average rate of 0.2739%. Short-term fixed/variable rate borrowing is expected to remain attractive for some time as the Bank of England maintains the base rate at historically low levels. Subject to credit conditions the borrowing strategy for the remainder of the year will be to take further short term loans whilst reviewing the potential for any affordable longer-term borrowing to improve the maturity profile of the Council's debt.

4.9 Debt Rescheduling

There has been no debt rescheduling in the period. Officers along with our advisers Arlingclose continue to monitor PWLB interest rates looking for opportunities to repay any debt, maximising the savings achieved whilst maintaining a balanced maturity profile.

4.10 Overall debt performance for the first part of the year

All new debt taken in 2013-14 has been in short-term borrowing to meet cashflow/capital financing requirements. Over the period total loan debt has increased by £17.605m as a result of an increase in short-term borrowing due to the improvement in credit conditions and the use of cashflow balances. The increase in short-term borrowing has resulted in a reduction in the average rate on external borrowing from 4.4078% on 1st April 2013 to 3.7753% on 30th September 2013.

4.11 PWLB borrowing

In August HM Treasury announced details of a "Certainty Rate" which will enable "eligible authorities" to access cheaper PWLB funding, with a 20 basis point reduction on the standard PWLB borrowing rate. Initially announced in the March 2012 Budget, HM Treasury have introduced this initiative to incentivise local authorities to provide robust forecasts on borrowing plans. The Authority qualifies for borrowing at the 'Certainty Rate' (0.20% below the PWLB standard rate) for a 12 month period from 01/11/2012. In April the Authority submitted its application to the CLG along with the 2013-14 Capital Estimates Return to access this reduced rate for a further 12 month period from 1st November 2013.

The PWLB remained an attractive source of borrowing for the Authority as it offers flexibility and control. As concerns mounted over the timing of the removal or 'tapering' of QE by the US Federal Reserve, gilts sold off and yields rose in May and June. The sharp rise in gilt yields led to a corresponding rise in PWLB rates (see Appendix 1), with the most pronounced increase for 10 year loans where rates as at 30th September were 0.83% higher than 1st April. Affordability and the "cost of carry" remained important influences on the Authority's borrowing strategy alongside the consideration that, for any borrowing undertaken ahead of need, the proceeds would have to be invested in the money markets at rates of interest significantly lower than the cost of borrowing.

Due to affordability and credit risk the current borrowing strategy is to take short-term borrowing at very low rates. However the Section 151 officer will continue to monitor interest rates and credit conditions and consider long-term borrowing in line with the approved 2013/14 Treasury Management Strategy.

Investments

4.12 Managing Investment Risk

4.12.1 The Guidance on Local Government Investments in England gives priority to security and liquidity and the Council's aim is to achieve a yield commensurate with these principles.

4.12.2 Security of capital remained the Council's main investment objective. This has been maintained by following the Council's counterparty policy as set out in its Treasury Management Strategy Statement for 2013/14. This restricted new investments to the following:

- The Debt Management Agency Deposit Facility (DMO)
- Treasury Bills (T-Bills) issued by the UK Government
- Term Deposits or business reserve accounts with UK banks or building societies
- Deposits with other local authorities
- Deposits with highly credit rated foreign banks
- Certificate of deposits with banks and building societies
- Bonds issued by Multilateral Development Banks, such as the European Investment Bank
- Gilts (Bonds issued by the UK government)
- AAA-rated Money Market Funds with a Constant Stable Net Asset Value investing in instruments issued predominantly in government securities
- AAA-rated Money Market Funds with a Constant Stable Net Asset Value investing in instruments issued primarily by financial institutions
- AAA-rated Money Market Funds with a Variable Net Asset Value
- Other Money Market Funds and Collective Investment Schemes which meet the definition of a collective investment scheme as defined in SI 2004 No 534 and SI 2007 No 573.
- Commercial Paper
- Corporate Bonds
- Investments with Registered Providers of Social Housing (housing associations)

4.12.3 Counterparty credit quality is assessed and monitored with reference to Credit Ratings (the Council's minimum long-term counterparty rating of A- (or equivalent) across rating agencies Fitch, S&P and Moody's); credit default swaps; GDP of the Country in which the institution operates; the Country's net debt as a percentage of GDP; sovereign support mechanisms/potential support from a well-resourced parent institution; share price.

4.13 Counterparty Update

In April, Fitch downgraded the UK's long-term sovereign rating by one notch from AAA to AA+, the second of the rating agencies to do so (Moody's had downgraded the UK's ratings in February to Aa1). Where assigned, local authorities' ratings, which benefit from an uplift due to their close and direct links to central government, were also downgraded.

The proposed sale of 632 Lloyds' branches to the Co-op Bank – referred to as Project Verde – fell through in April. These branches will now be transferred in September to TSB Bank, a new bank which will be sold through a listing on the stock market in 2014.

In May, Moody's downgraded the long-term rating of Co-op Bank by six notches from A3 to Ba3 which is sub-investment grade. The downgrade reflected the agency's opinion that the bank faced the risk of further substantial losses in its non-core portfolio. In June the Co-op announced it had a £1.5bn regulatory capital shortfall requiring a recapitalisation via burden-sharing with junior creditors and asset disposals of its parent's insurance businesses. Moody's downgraded the bank's long-term rating a further four notches to Caa1 whilst Fitch downgraded this rating from BBB- to BB-. The Co-op is the Authority's banker and therefore the Authority has daylight exposure to the institution. Officers have put in place working practices to reduce this exposure by transferring funds within the Co-op account to offset individual account credits and debits and clearing any surplus balance to one of the Council's call accounts held with either Barclays, RBS, Bank of Scotland or Santander. These actions are undertaken throughout the day to limit both daylight and overnight exposure. The minimum balances are left in the Co-op accounts for operational purposes.

In the Chancellor's Mansion House speech on 19th June he signalled his intention to sell the Government's stake in the Lloyds Banking Group reasonably soon and a 6% stake was indeed sold to institutional investors on 17th September at a price of 75p. In a positive move, Fitch upgraded Lloyds' viability rating to bbb+. The situation was more complicated with RBS since its problems were greater and reflected in its share price. It appeared that a 'good bank' and 'bad bank' split for RBS was being favoured by the Chancellor and sat behind the announcement concerning the departure of RBS Chief Executive, Stephen Hester, who disagreed with that route.

Moody's placed the RBS's long-term rating of A3 and standalone financial strength rating of D+ on review for downgrade on 5th July 2013, amid concerns about the impact of any potential breakup of the bank on creditors. Although the probability of losses remains low there is a possibility of capital impairment especially as the government has clearly indicated that it will not put up any further taxable funds. As a precautionary measure the Authority has reduced its maximum duration on RBS investments to overnight.

4.14 <u>Investment Activity</u>

4.14.1 Investments are made short term to cover cash flow and liquidity requirements and longer term to maximise and guarantee future income. The continuance of a historically low base rate and the introduction of the Funding for Lending Scheme (FFLS), where the Bank of England provides cheap funding to banks and building societies, resulted in a reduction in the returns available on the Council's deposits with these institutions. With rates falling the following deposits were taken in the period to give some protection to investment returns.

Amount	Start Date	End Date	Term (days)	Rate %
£5.0m	21/05/13	21/08/13	92	0.70
£5.0m	21/05/13	21/11/13	184	0.80
£5.0m	16/08/13	18/11/13	94	0.70

4.14.2 With bank deposit rates falling council officers have looked at alternative investment products to diversify away from pure cash deposits, achieve additional returns, and to add to the £5m invested in the CCLA Lamit Property Fund in March 2013. After discussion with the Council's Treasury Management Advisers (Arlingclose), a number of fund managers were interviewed and the following funds chosen:

- Federated Prime Rate Cash Plus Fund
- Ignis Sterling Short Duration Cash Fund
- Investec Short Bond Fund
- Investec Target Return Fund
- Payden & Rygel Sterling Reserve Fund

£1m has been deposited in each of these funds investing in a range of investments and asset classes including Certificates of Deposits (CD) and Floating Rate Notes (FRN), Government and Corporate Bonds and Asset Backed Securities (ABS). The target return on these funds will produce around 1%. These funds are variable and officers will monitor their performance with a view to consolidation and possible further investment. The performance of these funds will be included in the Treasury Management out-turn report.

4.14.3 Figure 2 below shows the split of investments over country/sector as at 30th September 2013. In terms of risk management, the majority of the investment portfolio is now held in UK institutions. These institutions are of systemic importance to the UK economy.

Figure 2

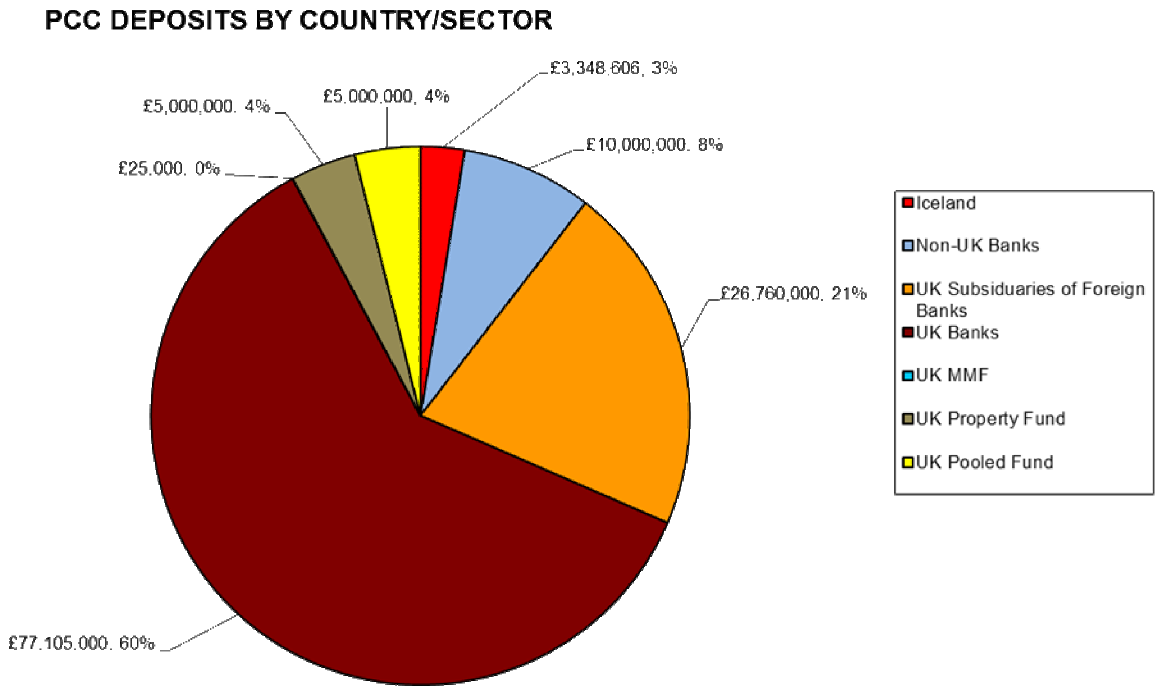
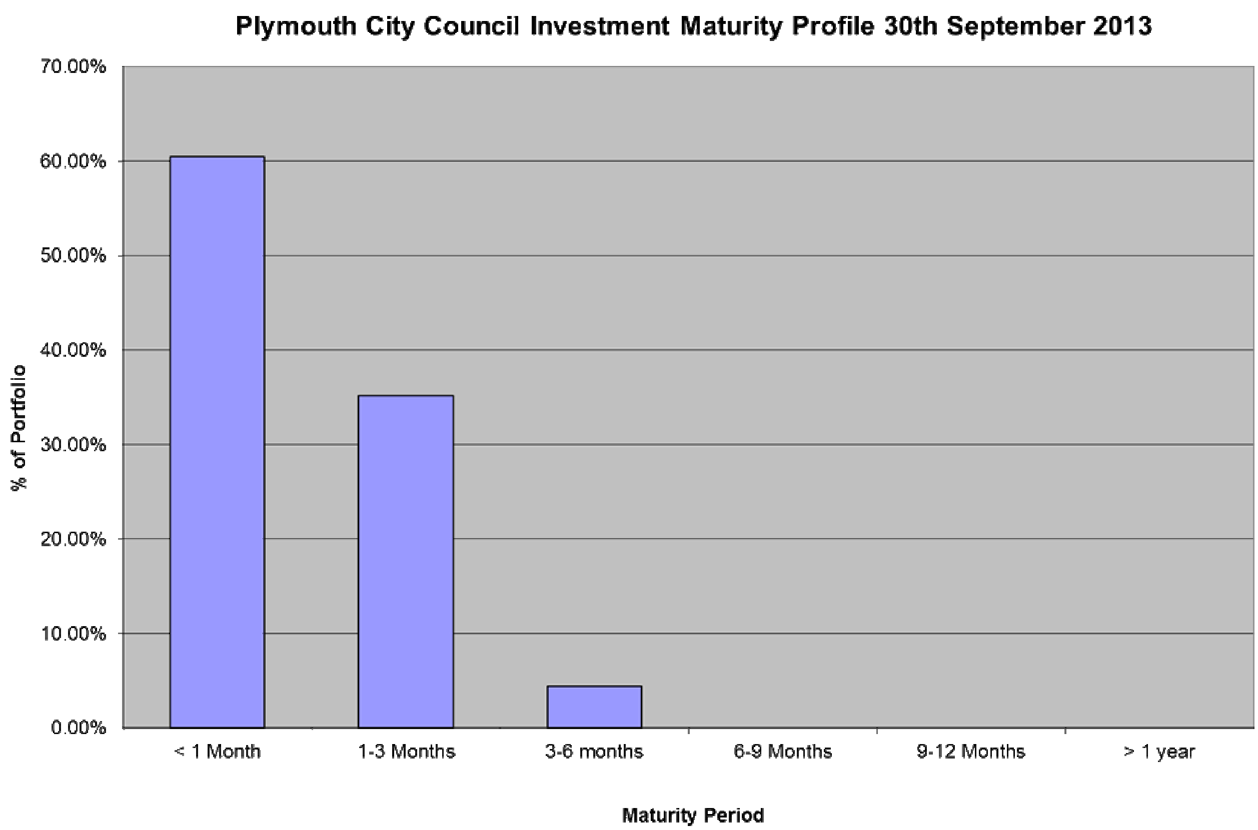


Table 3

Counterparty	Total
	£m
Iceland	3.349
Banco Santander	
Santander UK (was Abbey National)	26.760
Lloyds Banking Group	
Bank of Scotland	10.003
Lloyds TSB	5.000
Barclays	26.825
Royal Bank of Scotland (RBS)	
RBS	20.304
HSBC	10.000
Svenska Handelsbanken (Swedish Bank)	10.000
Close Brothers	5.000
CCLA Lamit Property Fund	5.000
Federated Prime Rate Cash Plus Fund	1.000
Ignis Sterling Short Duration Cash Fund	1.000
Investec Short Bond Fund	1.000
Investec Target Return Fund	1.000
Payden & Rygel Sterling Reserve Fund	1.000
CCLA Public Sector Deposit Fund	0.025
Total	**127.266**

4.14.4 The maturity profile of the Council's deposits is represented in figure 3. This shows a large proportion of deposits maturing in less than one month, reflecting the deposits in call accounts, giving the liquidity requirement to meet cashflow and the ability to react to adverse changes in market conditions. In the period covered by this report the treasury management officer has continued to negotiate rates on the Council's call accounts which in most cases pay higher than available fixed term deposits out to the maturity limits in place. The deposits beyond 1 month are 3 and 6 month deposits with Lloyds Banking Group where rates are higher than those available on the call account with this group.

Figure 3



4.15 Credit Risk

4.15.1 The Treasury Management Strategy report to Audit Committee in February 2010 outlined a recommendation that officers work to develop a set of benchmarking criteria against which the Council's investment risk could be measured. The Council's treasury advisers, Arlingclose, as a result developed the following matrix to score the credit risk of an authority's investment portfolio. This continues to be used in 2013-14:

Scoring:
-Value weighted average reflects the credit quality of investments according to the size of the deposit
-Time weighted average reflects the credit quality of investments according to the maturity of the deposit
-AAA = highest credit quality = 1

- D = lowest credit quality = 26
-Aim = A- or higher credit rating, with a score of 7 or lower, to reflect current investment approach with main focus on security

4.15.2 Table 3 shows the rating currently attached to the Council's portfolio and its movement during the year.

Table 3

Date	Value Weighted Average – Credit Risk Score	Value Weighted Average – Credit Rating	Time Weighted Average – Credit Risk Score	Time Weighted Average – Credit Rating
31/03/2013	6.00	A	6.25	A
30/06/2013	6.12	A	5.16	A
30/09/2013	5.73	A	4.67	A

Note: These scores exclude any deposits with Icelandic banks.

Based on the scoring methodology, the Council's counterparty credit quality has improved during the year as a result of the use of higher rated banks such as HSBC and Svenska Handelsbanken and investments in High rated managed funds. Throughout the first half of the year the Council's credit score was maintained well within the target level of 7 as set in the approved 2013/14 strategy.

4.15.3 Arlingclose have used the scoring matrix to compare Plymouth's investment risk against other unitary authorities who use Arlingclose as their advisers. The results are shown in section 5.

5. Benchmarking

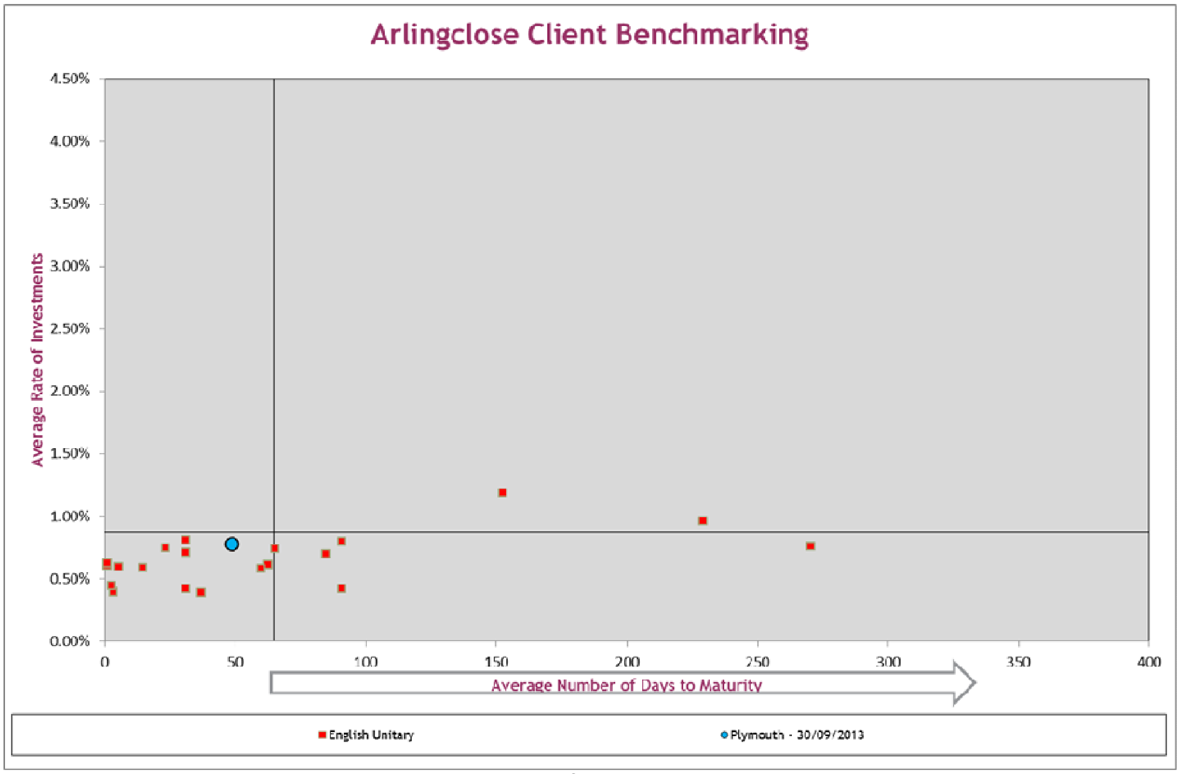
5.1 The Council's performance on investments is measured against a benchmark of the 7 day libid rate. For the period to 30th September 2013 the return on investments made in 2013/14 was 0.8090% against the average 7 day Libid for the period of 0.43%.

5.2 As outlined above, Arlingclose have developed a set of benchmarking criteria to enable comparisons on performance to be made on data provided by all their clients. To compare like with like the following graphs compare our performance with other unitary authorities. This is based on data provided to 30th September 2013.

The 3 graphs used for comparison are:

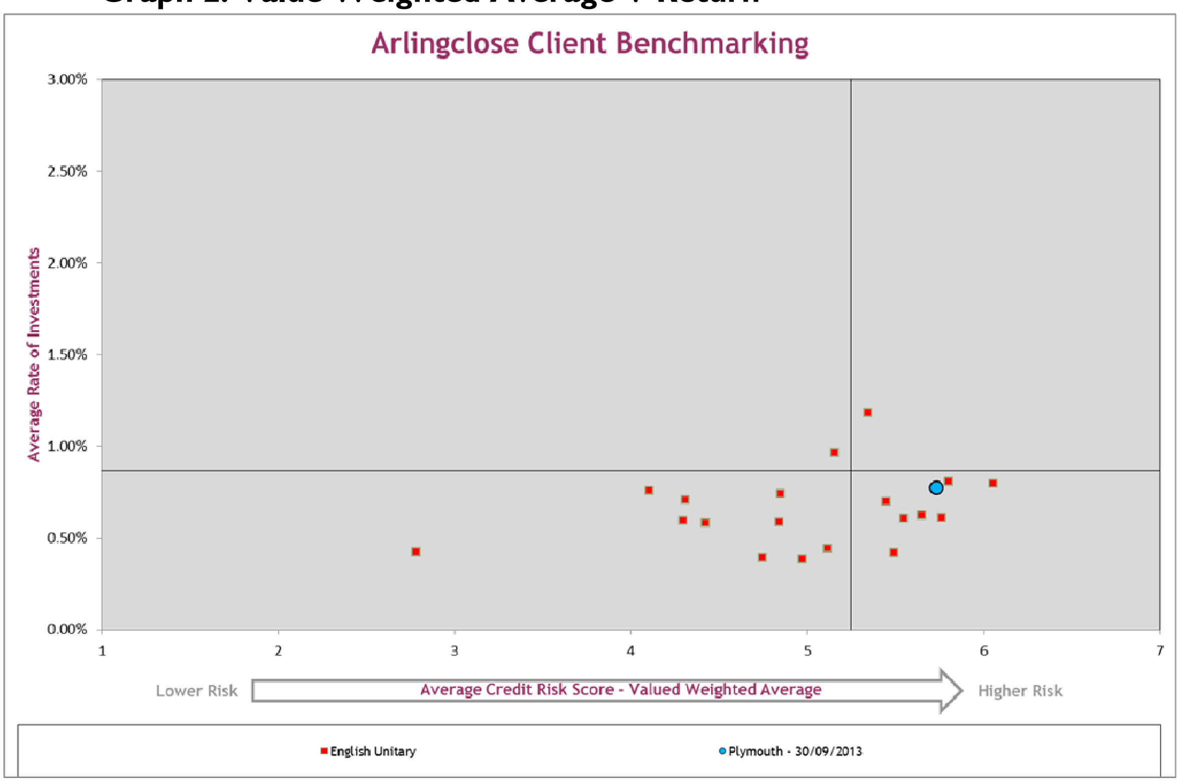
1. Average rate of investment against average maturity period
2. Average rate of investment against value weighted average credit risk score
3. Average rate of investment against time weighted average credit risk score

Graph I Average Number of days to Maturity V Return



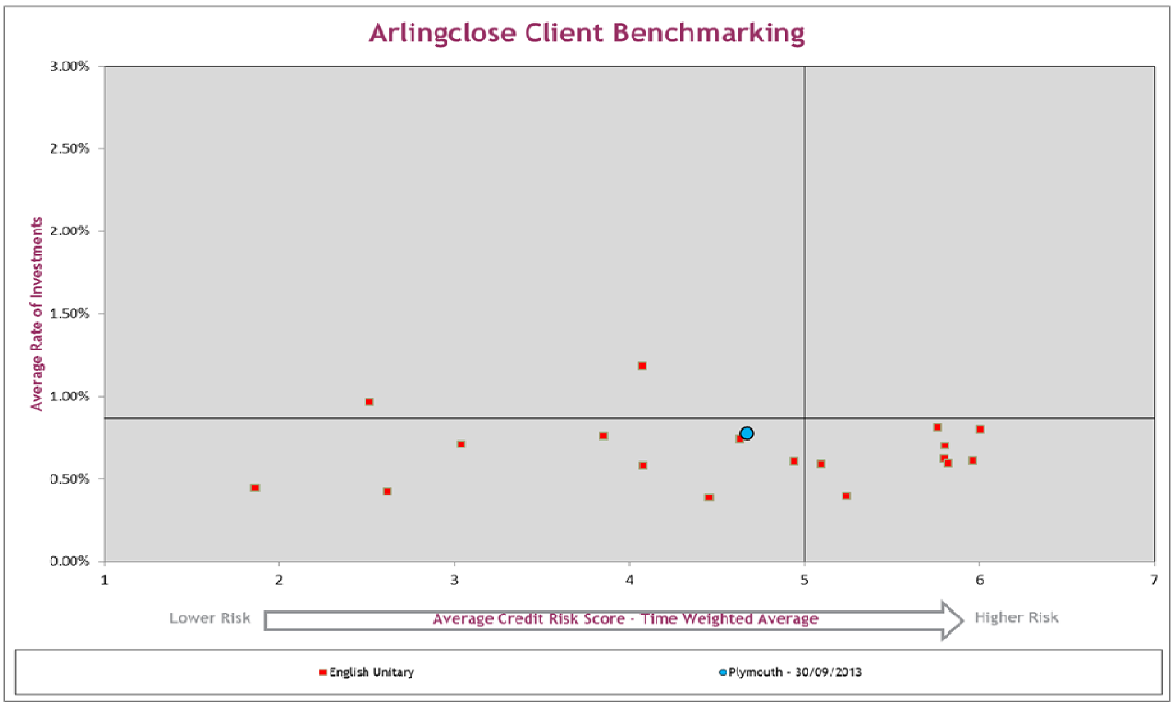
This graph shows the duration of investments against return. It shows the Council's investments have performed well against the majority of other unitary authorities reflecting the higher rates negotiated on call accounts

Graph 2. Value Weighted Average V Return



As a general rule the aim should be to convert a greater average length of portfolio duration into a greater than average return. There should be a positive correlation between duration and return. However this chart should not be viewed in isolation from other measured parameters and it should be noted that a high average number of days to maturity does not necessarily mean a higher risk, in fact the reverse may be considered true in some cases. The majority of the Council's investments are in call accounts with UK banks with short-dated maturities. These banks have been downgraded increasing the credit risk score but are still of systemic importance to the UK economy and as such are considered secure investments.

Graph 3 Time weighted Average V Return



Longer-term investments with banks are inherently more risky. Ideally authorities should move towards the top left corner of the above graph. Therefore it is preferable to see risk taken converted into return at a greater than average rate. All the Council's investments are in short-term deposits or instant access call accounts and highly rated managed funds so there are no longer-term deposits impacting on our credit risk score. The lower risk scores of other unitary authorities are due to the use of Money Market Funds (MMF) which are AAA rated giving the lowest credit risk score. It has been the policy of the Council to use call accounts with UK banks in the first half of the year as opposed to the alternative of liquid MMF's. Although MMF's are rated AAA the instruments within these funds have far lower ratings. Arlingclose are reviewing their credit risk scores to reflect this. Over time this will bring the scores of other authorities closer to that of this Authority.

6. Revenue Implications of Treasury Management

6.1 The expenditure and income arising from the Council's borrowing and investments accrues to the revenue accounts. This includes interest payable and receivable, the minimum revenue provision (for debt repayment), and premiums and discounts written out to revenue from previous debt rescheduling. Some of the interest receivable is passed on to specific accounts where this interest has accrued from the investment of surplus balances for these services. The balance (net cost) is met by the General Fund. The table below shows the monitoring positions against budget arising from these transactions in 2013/14 to 30th September 2013.

Summary of Capital Financing Costs 2013/14

	2013/14 Budget £000	Forecast 2013/14 Outturn £000	Variance £000
External Interest payments	9,610	8,789	(821)
External Interest received	(1,133)	(906)	227
Interest transferred to other accounts	15	15	0
Premiums / Discounts written out to Revenue	(189)	(148)	41
Debt Management Expenses	126	126	0
Treasury Management Cost	**8,429**	**7,876**	**(553)**
Minimum Revenue Provision	8,101	8,188	87
Recharges for unsupported borrowing	(4,267)	(4,267)	0
Recovered from trading Accounts	(2,805)	(2,805)	0
Net Cost to General Fund	**9,458**	**8,992**	**(466)**

7 Icelandic Bank Update

7.1 The latest position on the recoveries of monies invested in the Icelandic banks is as follows:

Glitnir – received £5,033,247.31 (principal £4,742,018.12 and interest £291,229.19) amounting to 79.03% of our agreed claim leaving a balance yet to be recovered of £1,335,240.36.

Landsbanki – received £2,205,901.96 (principal £1,887,758.90 and interest £105,778.37) amounting to 52.22% of our agreed claim leaving a balance yet to be recovered of £2,018,233.28.

Heritable – received £2,964,327.74 (principal £2,820,520.30 and interest £143,807.44) amounting to 94.02% of our claim leaving a balance of £188,630.63 yet to be recovered.

8 Compliance with Prudential Indicators

8.1 Under the arrangements set out in the Prudential Code for Capital Finance in Local Authorities, individual authorities are responsible for deciding the level of their affordable borrowing, having regard to the Code, and for establishing a range of prudential indicators covering borrowing limits and other treasury management measures. The Prudential Indicators for 2013/14 were approved by Council on 25h February 2013.

The performance to 30th September 2013 against these limits are set out below:

(a) Gross Debt and the Capital Financing Requirement

This is a key indicator of prudence. In order to ensure that over the medium term debt will only be for capital purposes, the Local Authority should ensure that debt does not, except in the short term, exceed the total of the capital financing requirement in the preceding year for the current and next two financial years.

If in any of these years there is a reduction in the capital financing requirement (CFR), this reduction is ignored in estimating the cumulative increase in the CFR which is used for the comparison with gross external debt.

Based on the current capital programme the maximum CFR estimated over the next 3 years is £285.088m. At the start of the year total debt was £267.794m. This fluctuated during the first 6 months of the year to reach a maximum level of £286.899m on 24th September 2013. By the 30th September this had fallen to £285.4m, back below the CFR. Short term cashflow requirements will sometimes mean the debt will be above the CFR but the Section 151 officer can report that the Authority had no difficulty meeting the requirement in 2012/13 or the current year to date.

(b) Authorised Limit and Operational Boundary for External Debt

The Local Government Act 2003 requires the Council to set an Affordable Borrowing Limit, irrespective of their indebted status. This is a statutory limit which should not be breached. It is measured on a daily basis against all external borrowing items on the balance sheet (i.e. long and short term borrowing, overdrawn bank balances and long term liabilities). It is consistent with the Council's existing commitments, its proposal for capital expenditure and its approved Treasury Management Policy/Strategy.

The Council's Affordable (Authorised) Borrowing Limit was set at £310m for 2013/14 including a limit for other long term liabilities of £40m to cover PFI, Finance Leases and Tamar Bridge debt.

The Operational Boundary is based on the same estimates as the Authorised Limit but reflects the most likely, prudent but not worst case scenario without the additional headroom included within the Authorised Limit. It is a focus for the day to day treasury management and a means by which the authority manages its external debt within the self-imposed Authorised Limit. The Operational Boundary may be breached at certain times during the year due to short-term cashflow requirements.

The Operational Boundary for 2013/14 was set at £289m.

There were no breaches to the Authorised Limit or Operational Boundary to 30th September 2013 with the total external debt (including PFI, Finance Leases and Tamar Bridge debt) reaching its maximum level of £286.899 on 24th September 2013.

(c) Upper Limits for Fixed Interest Rate Exposure and Variable Interest Rate Exposure

These indicators allow the Council to manage the extent to which it is exposed to changes in interest rates.
The upper limit for variable rate exposure allows for the use of variable rate debt to offset exposure to changes in short-term rates on our portfolio of investments.

	Limits for 2013/143 %
Upper Limit for Fixed Rate Exposure	200
Maximum exposure in 2013-14	193.11
Compliance with Limits:	Yes
Upper Limit for Variable Rate Exposure	50
Maximum exposure in 2013-14	0.37
Compliance with Limits:	Yes

The Council's exposure to both fixed and variable rates was managed well within the limits set during the first half of the year.

(d) Maturity Structure of Fixed Rate Borrowing

This indicator is to limit large concentrations of fixed rate debt needing to be replaced at times of uncertainty over interest rates, and is designed to protect against excessive exposure to interest rate changes.

It is calculated as the amount of projected borrowing that is fixed rate maturing in each period as a percentage of total projected borrowing that is fixed rate. The maturity of borrowing is determined by reference to the earliest date on which the lender can require payment. The repayment of the majority of PWLB loans on stock transfer has resulted in a high proportion of Lobo (Lenders Option, Borrowers Option) loans which may be subject to rate change or repayment at specified intervals. On specified dates the Lender has the option to vary the rate. If the option is taken the Council (Borrower) has the option to repay the loan. Therefore the loan may be subject to repayment on a number of occasions throughout the life of the loan. These repayment possibilities are included in the limits set for the maturity of fixed rate borrowing and the monitoring of actuals against these limits. The following table shows the performance against limits during the year.

Maturity Structure of Fixed Rate Borrowing	Upper Limit %	Lower Limit %	Highest % of Actual Fixed Rate Borrowing during 13-14	Lowest % of Actual Fixed Rate Borrowing during 13-14	Compliance with Set Limits?
under 12 months	40	0	20.42	7.88	Yes
12 months and within 24 months	60	0	47.02	31.87	Yes
24 months and within 5 years	40	0	22.92	10.45	Yes
5 years and within 10 years	25	0	4.56	1.94	Yes
10 years and within 20 years	25	0	2.86	2.86	Yes
20 years and with 30 years	25	0	5.37	5.37	Yes
30 years and within 40 years	30	0	6.36	4.67	Yes
40 years and within 50 years	35	0	17.18	15.50	Yes
50 years and above	25	0	0.00	0.00	Yes

(e) Total principal sums invested for periods longer than 364 days

- This indicator allows the Council to manage the risk inherent in investments longer than 364 days.
- The limit for 2013/14 was set at £20m.
- On the advice of the Council's advisers no deposits were made beyond 364 days during the first half of the year. Some investments were made in managed funds which could be held for longer term but as they are liquid and can be cashed in at short notice they are viewed as short term investments. Having not taken any deposits over 364 days in the first half of the year the Council still has space for up to £20m of longer-term deposits should this be viewed as appropriate in light of credit conditions, available counterparties and the risk/reward of these investments.

(f) Credit Risk

- This indicator has been incorporated to review the Council's approach to credit risk.
- The Council confirms it considers security, liquidity and yield, in that order, when making investment decisions.
- Credit ratings remain an important element in assessing credit risk, but they are not the sole feature of the Authority's assessment of counterparty risk. The authority considers the following tools to assess credit risk.

- Published credit ratings of the financial institution and its sovereign;
- Sovereign support mechanism;
- Credit default swaps (where quoted);
- Share prices (where quoted);
- Economic fundamentals, such as country's net debt as a percentage of its GDP;
- Corporate developments, news, articles, market sentiment and momentum.

▪ The Council can confirm that all investments were made in line with minimum credit rating criteria set in the 2013/14 Treasury Management Strategy.
- Long-term ratings of A- or equivalent;
- Long-term sovereign ratings of AA+ or equivalent for non-UK sovereigns.

9. Outlook for Q3-Q4

9.1 At the time of writing this activity report in October 2013, the UK economic outlook appears to have improved. The projected path for growth has risen, but remains relatively subdued, with a distinct reliance on household consumption, which itself remains under pressure given the deterioration in real earnings growth, high unemployment and general low confidence. A variety of other factors will continue to weigh on a domestic recovery, including on-going fiscal consolidation, muted business confidence and subdued foreign demand. While the economic recovery may pick up steam, forward guidance from the Bank of England suggests that monetary policy is unlikely to be tightened until the ILO Unemployment Rate falls below 7%. The Bank projected this level would be reached in 2016. The latest forecast for Bank Rate from our advisers Arlingclose is below:

	Dec-13	Mar-14	Jun-14	Sep-14	Dec-14	Mar-15	Jun-15	Sep-15	Dec-15	Mar-16	Jun-16	Sep-16
Official Bank Rate												
Upside risk		0.25	0.25	0.25	0.25	0.25	0.50	0.50	0.50	0.75	0.75	0.75
Arlingclose Centra	**0.50**	**0.50**	**0.50**	**0.50**	**0.50**	**0.50**	**0.50**	**0.50**	**0.50**	**0.50**	**0.50**	**0.50**
Downside risk	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25

10 Summary

10.1 In compliance with the requirements of the CIPFA Code of Practice, this report provides members with a summary of the Treasury Management activity during the first half of 2013/14. As indicated in this report none of the Prudential Indicators have been breached and a prudent approach has been taken in relation to investment activity with priority given to security and liquidity over yield.

Appendix I

Money Market Data and PWLB Rates

The average, low and high rates correspond to the rates during the financial year rather than those in the tables below.

Please note that the PWLB rates quoted below relate to the standard rates. The Council is eligible for the Certainty rate which provides a 0.2% reduction.

Table 1: Bank Rate, Money Market Rates

Date		Bank Rate		O/N LIBID	7-day LIBID	1-month LIBID	3-month LIBID	6-month LIBID	12-month LIBID	2-yr SWAP Bid	3-yr SWAP Bid	5-yr SWAP Bid
01/04/2013		0.50		0.40	0.50	0.40	0.44	0.51	0.75	0.59	0.68	0.97
30/04/2013		0.50		0.50	0.47	0.40	0.44	0.51	0.75	0.57	0.64	0.91
31/05/2013		0.50		0.38	0.42	0.40	0.44	0.51	0.75	0.68	0.82	1.15
30/06/2013		0.50		0.43	0.38	0.40	0.44	0.51	0.75	0.78	0.99	1.52
31/07/2013		0.50		0.42	0.50	0.40	0.44	0.51	0.75	0.68	0.86	1.39
30/08/2013		0.50		0.43	0.41	0.41	0.44	0.51	0.76	0.81	1.10	1.71
30/09/2013		0.50		0.38	0.38	0.41	0.44	0.51	0.76	0.83	1.12	1.73
Average		**0.50**		**0.42**	**0.43**	**0.40**	**0.44**	**0.51**	**0.76**	**0.72**	**0.91**	**1.38**
Maximum		**0.50**		**0.50**	**0.50**	**0.45**	**0.53**	**0.65**	**0.84**	**0.95**	**1.32**	**1.99**
Minimum		**0.50**		**0.35**	**0.38**	**0.40**	**0.44**	**0.51**	**0.75**	**0.55**	**0.62**	**0.87**
Spread		--		**0.15**	**0.12**	**0.05**	**0.09**	**0.14**	**0.09**	**0.40**	**0.70**	**1.12**

Table 2: PWLB Borrowing Rates - Fixed Rate, Maturity Loans

Change Date	Notice No	1 year	4½-5 yrs	9½-10 yrs	19½-20 yrs	29½-30 yrs	39½-40 yrs	49½-50 yrs
01/04/2013	125/13	1.11	1.74	2.83	3.87	4.18	4.25	4.22
30/04/2013	166/13	1.16	1.72	2.72	3.74	4.06	4.13	4.08
31/05/2013	208/13	1.26	1.97	3.03	3.99	4.29	4.36	4.33
28/06/2013	248/13	1.22	2.34	3.49	4.30	4.52	4.56	4.54
31/07/2013	293/13	1.21	2.22	3.43	4.29	4.50	4.52	4.50
30/08/2013	335/13	1.28	2.53	3.74	4.43	4.54	4.54	4.53
30/09/2013	377/13	1.30	2.50	3.66	4.36	4.49	4.50	4.48
	Low	1.11	1.70	2.71	3.71	4.02	4.08	4.04
	Average	1.25	2.21	3.34	4.19	4.42	4.46	4.43
	High	1.40	2.80	3.99	4.62	4.71	4.72	4.71

Appendix 1

Table 3: PWLB Borrowing Rates - Fixed Rate, Equal Instalment of Principal (EIP) Loans

Change Date	Notice No	4½-5 yrs	9½-10 yrs	19½-20 yrs	29½-30 yrs	39½-40 yrs	49½-50 yrs
01/04/2013	125/13	1.30	1.80	2.87	3.52	3.88	4.08
30/04/2013	166/13	1.31	1.77	2.76	3.39	3.75	3.96
31/05/2013	208/13	1.49	2.02	3.07	3.67	4.00	4.19
28/06/2013	248/13	1.66	2.41	3.53	4.05	4.30	4.45
31/07/2013	293/13	1.58	2.29	3.47	4.04	4.30	4.44
30/08/2013	335/13	1.78	2.61	3.77	4.26	4.44	4.51
30/09/2013	377/13	1.79	2.58	3.69	4.17	4.37	4.45
	Low	1.29	1.76	2.75	3.37	3.72	3.91
	Average	1.61	2.28	3.38	3.93	4.20	4.35
	High	1.97	2.88	4.03	4.46	4.62	4.69

Table 4: PWLB Variable Rates

	1-M Rate	3-M Rate	6-M Rate	1-M Rate	3-M Rate	6-M Rate
	Pre-CSR	Pre-CSR	Pre-CSR	Post-CSR	Post-CSR	Post-CSR
01/04/2013	0.5700	0.5600	0.5500	1.4700	1.4600	1.4500
30/04/2013	0.5700	0.5500	0.5400	1.4700	1.4500	1.4400
31/05/2013	0.5600	0.5600	0.5600	1.4600	1.4600	1.4600
28/06/2013	0.5600	0.5600	0.5600	1.4600	1.4600	1.4600
31/07/2013	0.5500	0.5500	0.5500	1.4500	1.4500	1.4500
30/08/2013	0.5600	0.5600	0.5600	1.4600	1.4600	1.4600
30/09/2013	0.5700	0.5700	0.5700	1.4700	1.4700	1.4700
Low	0.5500	0.5500	0.5400	1.4500	1.4500	1.4400
Average	0.5640	0.5607	0.5576	1.4640	1.4607	1.4576
High	0.5800	0.5700	0.5700	1.4800	1.4700	1.4700

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